DOW THEORY LETTERS INC.

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THE MARKET: Question: did you ever see a day when copper prices are raised 20¢, copper stocks go "through the roof," all three leading auto stocks break to new lows for the year, the Industrial Average rise 7 points, Rails and Utilities decline, advances and declines are equal and volume rises to 12.9 million, third highest day in N.Y.S.E. history? Answer: April 14 was the day, we all saw it, but ironically, in a market this wild even April 14 did not create too much of a stir.

Question: what do you think is going on now? What is this market trying to do? Answer: The Averages recorded February 9th bull market peaks of 995.15 and 271.72. A full correction followed, taking the two Averages to March lows of 911.08 and 243.60. The subsequent recovery has continued long enough and far enough to qualify as a full upward correction. The market is slowly approaching the "moment of truth." The most important single question for Wall Street (and actually for the whole nation) is now in the process of being answered.

Think about this. Locked into the action of the D-J Industrial and Rail Averages is one of the greatest economic secrets of the generation. And the answer will almost surely be disclosed in the several months ahead. The secret, of course, is the true direction of the primary trend. Every informed investor is wondering whether the bull market is still intact or whether a bear market started last February 9th

The resolution of the market puzzle, when it arrives, will affect every segment of American life and for that matter it will surely influence the course of world history. A continuation of the primary bull trend will give our Administration a "new lease of life," it will temper any adverse effects of the coming Congressional elections, it will tend to reconfirm the decisions (good or bad) of our Washington planners. Conversely, if the primary trend did turn bearish last February 9th, then time is running out for the boom. In retrospect the current action will be seen by market historians as the "last gasp" of a titanic but dying bull market. If the primary trend has actually turned bearish then (by definition) there will be no new highs in the Averages, and somewhere ahead the current rally will fizzle and die,

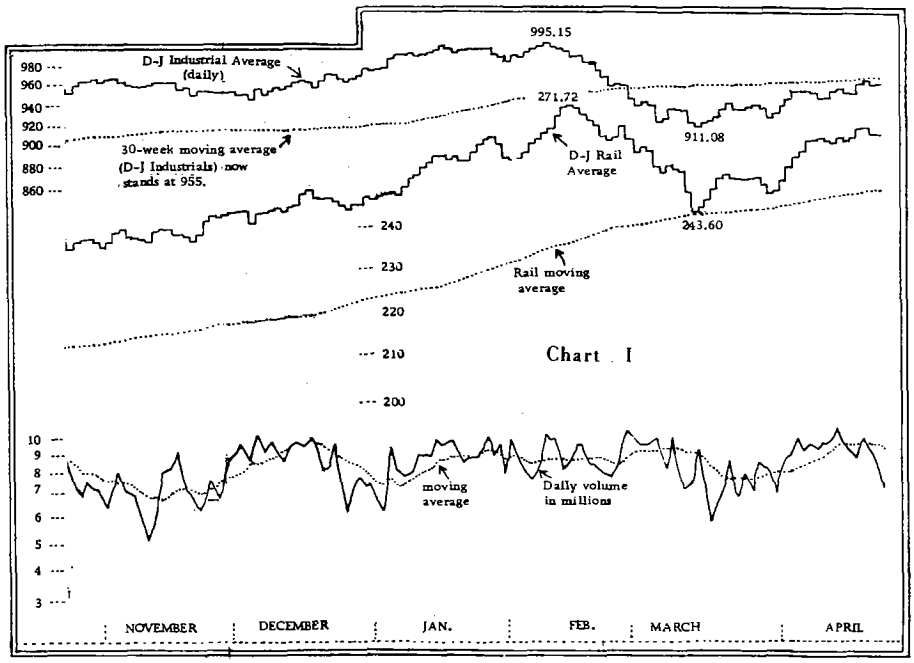
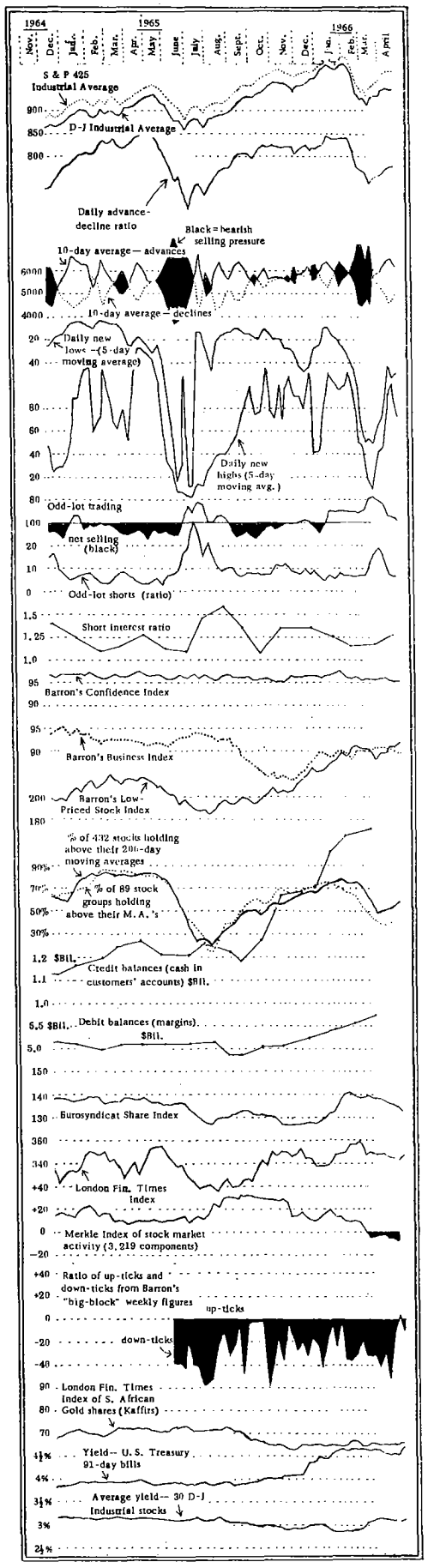


Chart I


1964
1965
1966
S & P 425 Industrial Average
D-J Industrial Average
Daily advance-decline ratio
Black = bearish selling pressure
10-day average — advances
10-day average — declines
Daily new lows — (5-day moving average)
Daily new highs (5-day moving avg.)
Odd-lot trading
net selling (black)
Odd-lot shorts (ratio)
Short interest ratio
Barron's Confidence Index
Barron's Business Index
Barron's Low-Priced Stock Index
% of 432 stocks holding above their 200-day moving averages
% of 89 stock groups holding above their M.A.'s
Credit balances (cash in customers' accounts) $Bil.
Debit balances (margins). $Bil.
Eurosyndicat Share Index
London Fin. Times Index
Merkle Index of stock market activity (3,219 components)
Ratio of up-ticks and down-ticks from Barron's "big-block" weekly figures
up-ticks
down-ticks
London Fin. Times Index of S. African Gold shares (Kaffirs)
Yield — U.S. Treasury 91-day bills
Average yield — 30 D-J Industrial stocks

to be follwed by a decline which will violate (probably crash through) the March lows of 911.08 and 243.60. Such an event would signal the beginning of changes so important and fundamental that their ultimate results can only be speculated upon at this time.

The market now appears to be at an important juncture, and I note five interesting factors, each of which is worth discussing.

(1) On April 21 the Industrial Average closed at 954.73, just a tiny fraction above the halfway level of the February-March decline. In Letter 320 I discussed the 50% Principle, a principle which takes cognizance of what the Dow does at the halfway level of the preceding advance or decline. The 50% Principle can be applied to the current market in the following way. The halfway level of the February-March decline (995.15 to 911.08) was 953.11. According to the 50% Principle, if the Dow approached 953.11 but refused to close above that figure, then the odds favored a return to and testing of the March low again. But if the Dow could close decisively (and hold) above 953.11, such action would mean that the market pendulum had swung up and beyond the mid-point of the entire February-March decline. In that case, the 50% Principle would be saying that the odds favored a further recovery with the chance that the Dow would test the 995.15 high recorded on February 9.

(2) The 30-week moving average of the Dow now stands at 955 (chart 1). On April 21 the Dow halted within 25¢ of this mark. It will be important to see whether the Dow can move decisively above the 30-week moving average.

(3) Many are now waxing poetic over the "bullish high volume" of recent weeks, but it should be noted that this record volume has not been generated with the Averages at new highs; rather it has come from an area well below the February highs. This is an important factor, and this writer is consequently not smitten with the bullish implications of today's huge volume of trading.

(4) In Letter 307 and again in Letter 314 I drew attention to the poor Utility

NOTES AND QUOTES: The following might be included under a column entitled, "The more things change, the more they are the same." It is a quote which I thought was particularly interesting, written by the Roman philosopher Cicero more than 2,000 years ago. It is not generally known that the Romans were the first to offer what is now termed "foreign aid." Here is Cicero writing prior to the collapse of the great Roman Empire.

"We are taxed in our bread and wine, in our incomes and our investments on our land and on our property, not only for base creatures who do not deserve the name of men, but for foreign nations, for complaisant nations who will bow to us and accept our largesse and promise to assist in the keeping of peace—these mendicant nations who will destroy us when we show a moment of weakness or our treasury is bare, and surely it is becoming bare! We are taxed to maintain legions on their soil, in the name of law and order and the Pax Romana, a document which will fall into dust when it pleases our allies and our vassals. We keep them in precarious balance only with our gold.

"Is the heart-blood of our nation worth these? Shall one Italian be sacrificed for Britain, for Gaul, for Egypt, for India, even for Greece, and a score of other nations? Were they bound to us with ties of love, they would not ask for our gold. They would ask only our laws. They take our very flesh, and they hate us and despise us. And who shall say we are worthy of more?"

* * *

The changing scene in "Olde England" is a bit of a shocker, and it was documented in a fascinating article in the National Observer (April 18): "Quite suddenly (the old) image has changed. It is as though one's spinster aunt, after a lifetime of respectability, had kicked off her shoes, quaffed a huge slug of whiskey, and begun to do a striptease.....Nowhere else do the boys wear their hair so long or the girls wear their skirts so short.....If it seems a dubious compliment, there is another one, even more dubious, England has become the mecca of the Pop World.....Since the law was relaxed, a fantastic crop of gambling establishments has sprung up from the lushness of Crockford's Club to the betting shops, which have opened up on every corner.....The atmosphere is reckless and feverish. Several sensitive Britons, recently returned from traveling in America or Europe, has said that England now strikes them as the most decadent nation in the Western world."

In view of all this, it is a little wonder that England's finances are also in "dreamland." Latest figures show further deterioration in the British trade balance from minus $166 million in February to minus $215 million in March. Meanwhile, the fundamentals look just as poor for the pound with the latest statistics from the London Economist (April 22) showing wages 5.1% above a year ago, retail prices 4.5% above a year ago and export prices 3% above a year ago.

Rumors have it that Europe might accept a 15% devaluation with an attmpt by other leading currencies to hold fast (i.e., not to devalue). In the writer's opinion, a devaluation of the pound could well come this year, but I am skeptical about the dollar holding up against such a devaluation for long. A second area for a forthcoming devaluation, the Canadian dollar.

* * *

Silver stocks have been moving up. One reason is that at the current rate of silver consumption, the U.S. might have to halt silver sales completely by early 1967. This could mean a rise in the price of silver to above $2 and perhaps nearer $3. Historically, there is a ratio between the price of silver and the price of gold, and this ratio varies between 15 to 16 to 1. Consequently, any substantial rise in the price of silver could touch off a gold-buying panic, leading to a gold embargo and an ultimate doubling or tripling of the price of gold. When the gold stocks finally make their moves, I expect it to be violent, and late-buyers will probably be "left at the post."

* * *

A glimpse into the cost of the Vietnam war was provided by William Bowen in an article in the April issue of Fortune ("The Vietnam War, A Cost Accounting"): Bowen says that when there were 235,000 Americans in Vietnam our cost were running $13 billions per year. If Defense Department requests that manpower be stepped up to 400,000 are honored, then the cost will rise to $21 billions, stated Bowen. Bowen notes that "...The costs to the enemy of repairing the damage are picayune compared with the costs to the U.S. of doing the damage."

* * *

Rising money rates are hitting the housing industry. The F.H.A. raised to 5 3/4% the rates on mortgages they back. But builders claim that this rate is still below the market and the feeling is that it will be raised again. Last week, the Los Angeles Times ran this story, and here we see the real picture on mortgage rates in the "hot" Southern California Area.

* * *

S&Ls Boost Home Loan Rates to 7% and Above

Sharp Rise Noted at Annual Meeting of Great Western

BY ARELO SEDERBERG
Times Staff Writer

The Southern California savings and loan industry has cracked the "7% barrier" on home loan rates.

Minimum rate for prime single-family home loans now is 7% and loans are being made up to 7½%, Stuart Davis, chairman and chief executive officer of Great Western Financial Corp., a S&L holding company, told about 300 curious shareholders at the company's 90-minute annual meeting here Tuesday.

The barrier was cracked "just this week," he said. Only three months ago, loans were being made at 5¾% to 6½%.

Latest in the Rhodesian-British drama is a probable trip by a top-ranking British minister (or a visit by Prime Minister Wilson himself) to South Africa. Britain wants to avoid an outright confrontation with S. Africa and hopes to persuade S. Africa to use its influence in bringing Rhodesia to the conference table. Without S. Africa's financial help, Rhodesia would not last out the year. South Africa is torn between the wish to keep Smith's white Rhodesian government going, and the wish to avoid possible U.N. sanctions against S. Africa herself. If sanction against S. Africa were invoked, the British pound would be certain to collapse. S. Africa is Britain's second largest trading partner, and Britain runs a $250 million favorable trade balance with S. Africa. Knowing this and knowing the danger to the pound (and subsequently the dollar) if sanctions are imposed, Britain and the U.S. are most anxious to avoid a showdown with S. Africa. Best hope, a face-saving deal between Britain and Rhodesia which would at least partially satisfy all concerned.

performance. Utility stocks tend to represent informed investment money. When in Letter 314 I noted that the Utility Average had dropped to a new low for the year, I also stated that the implications were bearish for the market. As a matter of fact, for many years the Utilites have tended to lead the other Averages. For instance, in 1962 the Utilities touched bottom in late May, one month prior to the low on the Dow. In 1965 the Utilities topped in February, three months before the top in the Dow. Then the real divergence began. All during the latter part of 1965 Utilities kept dropping to new lows, even while the Dow rallied. In February, 1966, the Dow climbed to its record 995.15 peak, then turned down to drop 84 "unexpected" points.

The Utility Average hit a low for the year (139.03) on March 2, 1966, thirteen days prior to the 1966 low on the Dow. During the next two months the Dow rallied back halfway to its February, 1966 high. Last Friday (April 22) the Utilities quietly fell to 139.06, just 3¢ above the low for the year. I would consider any Utility closing below 139.03 as a bearish omen for the market.

(5) The advance-decline ratio recorded a recovery high on April 11. The Dow pushed to two successive new recovery highs following the April 11 closing. Neither of the new Dow peaks were confirmed by the A-D ratio. Thus the Dow and the A-D ratio have been diverging for two weeks. A new high in the A-D ratio in the period ahead would, of course, eliminate a potentially dangerous divergence. But technically, a broad decline now (coming after divergence) would have unpleasant connotations.

* * * *

At this time, I feel that the implications of the Vietman situation for the market cannot be ignored. Remember, the big blue-chip stocks have not been acting well, while the stocks that are making the market "look good" currently have been the war-based issues such as airlines, rails, coppers, aircraft, electronics and specialties. If the Vietnam war ended, a bear market might start in earnest. It therefore behooves us to take a careful look at the Vietnam situation.

This is the way I see it: the largest and best organized group in Vietnam is the Buddhists. The odds are that the coming elections (scheduled for August 15) will put the Buddhists in nominal control. Given a Buddhist leadership, it is entirely possible that the Buddhists will ask us (1) to get out, or (2) to continue a limited "police action." The Buddhists have maintained that any civilian government must quickly vote on whether the war should be continued and whether the Americans should remain in Vietnam. They say that this will "legitimize" what has happened.

The Washington administration, in view of the above, must now be considering whether to (1) step up the war in an attempt to bring off a possible "victory" before the August 15 elections, or (2) to attempt direct negotiations with all parties in a face-saving effort to end the war before the elections (as per Senator Mansfield's April 18 statement).

The Viet Cong, meanwhile, is almost sure to obtain representation in any forthcoming Buddhist government. For that matter, Tri Quant, leader of the Buddhists, may well have communist leanings himself(a matter about which there is much speculation). At any rate, the Viet Cong has little to lose by breaking off large-scale engagements and waiting out the elections. I believe they will do this.

Tri Quant, considered the shrewdest politician in Vietnam, will also try to avoid anything which may upset the August 15 elections. His policy will probably be one of watchful waiting (with periodic warnings to the effect the elections had better take place as promised). Whatever plans Tri Quant has in store for Vietnam will probably not be known until after the election. But my guess is that Quant will ultimately ask the U.S. to leave or to cut back substantially in its war effort (i.e., cessation of bombing). The reasons why he might do this are many: (1) The inflation brought on by the U.S. war buildup has demoralized the Vietnamese. (2) Feeling against the U.S. is running strong, due to desecration of the countryside, inadvertent killing of civilians, ill-feelings over contrasting U.S. and Vietnamese living standards, language barriers and lack of communication between U.S. personnel and the Vietnamese. (3) Tri Quant and his group would emerge as national heroes if they could bring about a successful resolution of the war while retaining the good will and aid of Washington.

It boils down to this; if Tri Quant and the Buddhists take control, they will constitute some sort of "people's government," and they will be expected to act in the best interest of the people (and themselves, of course). Tri Quant will then have to decide whether the war itself or the Viet Cong constitutes the greatest danger to the nation and to the Buddhist party. My guess is that the Buddhists believe that they can deal successfully with the Viet Cong, If this is true, then the Vietnam war is running on borrowed time.

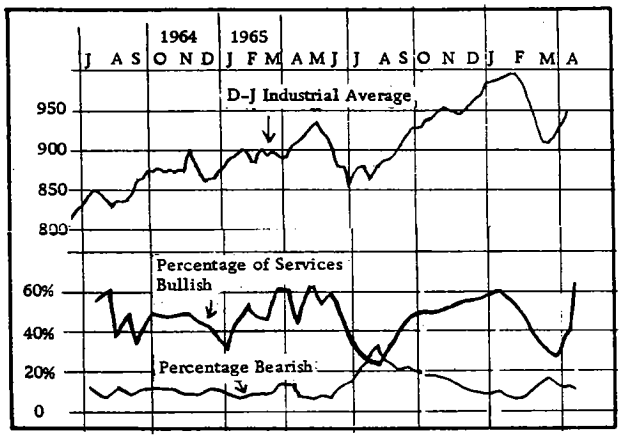
The incredible part of the whole story is that the U.S. with all its might can do so little, given the current trend of events. With all our power, we are still "guests" in a nation without a government, but we are faced with the possibility that we may be unwanted combatants after August 15, at which time a new Vietnamese government is fated to emerge offically.

To sum up, I do not see the whole picture (as painted above) as a bullish one for the market.

PROFESSIONAL OPINION: William P. Hamilton, Editor of the Wall Street Journal during the 1920's, frequently stated that he had never known the majority of Wall Street opinion to be correct. In the "Notes and Quotes" section of these Letters, I frequently include a sampling of opinion from other advisory services. Aside from the interesting comments contained in these samplings, I feel that it is of equal interest to note the predominance of bullish or bearish opinion at any given time. For when one side or the other becomes overly-weighted, it is frequently good policy to take the opposite stance.

This procedure is reduced to a more scientific basis by Investors Intelligence of Larchmont, N.Y. Every two weeks this organization lists representative opinion from approximately 25 leading advisory services. This opinion is then broken down into a "Bull column," a "Bear column," and a "Consolidation or correction" column.

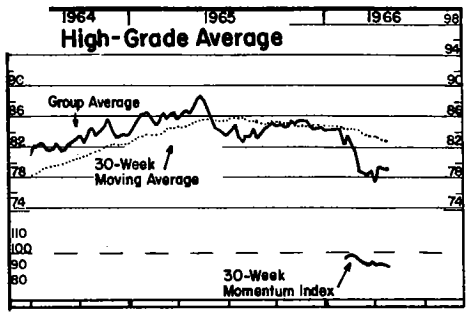
I have charted the bull and bear percentage (from Investors Intelligence) for the past few years, and the results are interesting. As a rough rule, whenever the bull column gets up around 55 to 60% and the bear column drops to around 6 to 12%, it seems that the optimism is too one-sided. At such times, the market is at or near a peak.



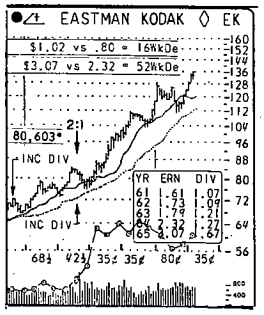
Such a "danger area" of overly optimistic professional opinion appeared during April and May, 1965 (see chart), just prior to the 100 point (Dow Industrial) drop in 1965. Bullish and bearish opinion went into a complete reversal during July and August, 1965, prior to the rise in the Dow to new highs. Bullishness increased again in the rise. On December 29, 1965, bull opinion rose to 61% again while bearish opinion dropped to 8.5%. By the end of January, 1966, bearishness had dropped to an extreme low of 5.2%. This occurred a week before the "unexpected" 84 point drop of February-March, 1966.

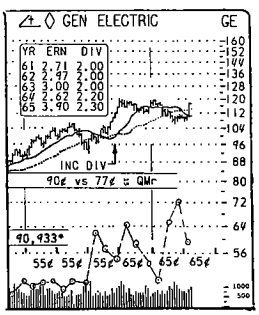
Caught unawares, most of the services backtracked and hedged during the violent February-March drop, and as seen on the chart the bullish percentage dropped sharply. On March 23 the bulls had receded from their earlier high of 61% to a low of 28% while bears had increased to 18%. On April 6 the bull pen was back to 40% while the bears had receded to 13%. This caused Investors Intelligence to remark, "The leading advisory services are scrambling to get on the bullish bandwagon.....Everything that happens both on the domestic front and in foreign affairs gets a bullish interpretation." Latest figures (for April 20) show 64% of the services bullish, 11% bearish. This is the type of spread which in the past has foreshadowed trouble in the market.

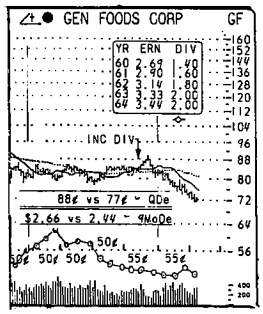
STOCKS: Last week I included a chart of Standard & Poor's Low-Priced Stock Index and the Dow. The extraordinary current situation is further underscored by this week's inclusion of S & P's High-Grade Stock Average. Here we see what appears to be a bear market in high-grade issues. The H-G Average topped out in early 1965; it broke down badly during the first quarter of 1966. Note that the moving average of H-G stocks is now declining with the H-G Average holding below the moving average. With the bloom now probably off the "high flyer" segment of the market, the important question is whether the high-grade issues will rally or whether all stocks will decline together.

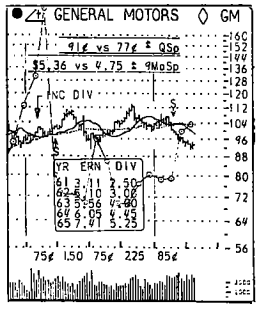


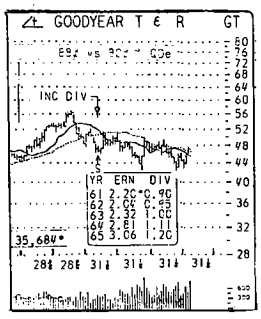
To continue Letter 320's discussion of the all-important Dow stocks (these 30 stocks comprise 1/3 of the total value of the N.Y.S.E.), this week 11 Dow stocks were holding above their moving average, 2 were neutral, and 17 Dow stocks were below their moving average.

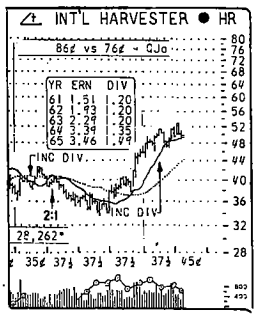


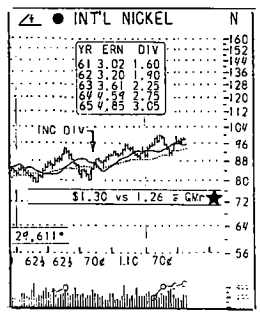


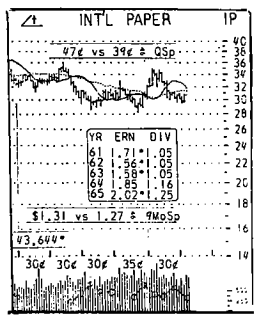












Of the 8 stocks pictured in this mailing, Kodak, Harvester and Nickel are still in well-defined bull trends. General Foods and General Motors are in well-established bear trends. Gen. Electric, Goodyear and Int. Paper are below their highs but are not in any strong trends either way. The latest earnings for the big stocks are good, in some cases remarkably good. But the good news is well known. The overriding question is the primary trend of the market, and this question will only be answered (see page 1) in the period ahead—the answer will be provided by the Average alone.

Charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.